Steady growth amid headwinds

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Domestic sector is expected to lift Malaysia's economy in the face of an uneven global recovery

A BRAND new year but with the same old story of external challenges and internal strength. That should sum up what's in store for the Malaysian economy in 2013.

Despite the weak and uncertain global economic conditions, there is remarkable optimism that Malaysia's economy could still continue to grow at a relatively healthy pace.

The government has, in fact, targeted a gross domestic product (GDP) growth rate of between 4.5% and 5.5% for 2013. This is quite an encouraging growth rate, and an achievable one at that, according to most economists.

The consensus view among private-sector economists is that despite the economic openness of Malaysia, which makes it vulnerable to external shocks, the country should remain resilient in 2013, with GDP growing at least 5%, which was around the same rate of growth expected for 2012.

So, what's shielding Malaysia from the challenging external environment? Two words: Domestic demand.

"The Malaysian economy has weathered the global slowdown remarkably well in 2012, due to the country's strong domestic fundamentals," Affin Investment Bank Bhd chief economist Alan Tan writes in his recent outlook report, noting that domestic demand, particularly private consumption and investment, would continue to be the main drivers of growth in 2013.

"Demand conditions remain relatively strong and will likely cushion the risk of a slower increase in exports if external environment deteriorates. We expect the country's private sector to lead growth in 2013, while public investment to lend support on the back of higher government activities," Tan argues.

Fundamental shift

Positive economic results have been evident since Malaysia embarked on a transformation journey two years ago, economists say.

CIMB Group Holdings Bhd chief economist Lee Heng Guie, for one, observes that there has been a favourable trend, which marks a "fundamental shift towards internal growth rebalancing" and a "new normal in Malaysia's growth cycle", thanks to the catalytic initiatives found in the Government Transformation Programme (GTP) and Economic Transformation Programme (ETP).

"Domestic demand has consistently flexed its muscle to counter weak external demand," Lee says in his outlook report, noting that domestic demand has remained consistently resilient since 2010, as a result of strong consumption and investment growth.

Lee argues that private consumption growth in 2013 would remain supported by government measures that are aimed at boosting income and consumption, as well as a manageable inflation and low interest rate environment and a firm labour market, while investment growth is also expected to stay robust as a result of ongoing reform efforts.

"We believe Malaysia is poised to enter an era of strong private-investment growth," Lee says, attributing the phenomenon to improvements in the domestic investment climate and catalytic push from the ETP.

Lee also expects public investment to continue gathering momentum, as the government increases spending for the transport, utility and oil and gas sectors.

GDP growth projection by selected organisation *(% year-on-year)*

	2012E	2013F
Official	~5.0	4.5 - 5.5
World Bank	5.1	5.0
MIDF Research	5.3	5.8
Malaysian Institute of Economic Research	5.1	5.6
CIMB Reseach	5.2	5.5
Royal Bank of Scotland	5.3	5.5
RHB Research	5.2	5.4
TA Research	5.4	5.2
Barclays Bank	5.2	5.1
Affin Research	5.2	5.0
Alliance Research	5.2	5.0
Nomura Equity Research	5.3	4.3
ICAEW	~5.0	3.8

*Note: E = estimate
F = forecast*

Bearish view

While it is undeniable that Malaysia's economic growth in 2013 would remain supported by its strong domestic demand, not everyone is convinced that the country can maintain the same pace of growth expected for 2012.

Among the handful who think that Malaysia's GDP growth would decelerate in 2013 is the Institute of Chartered Accountants in England and Wales (ICAEW).

The Europe-based professional accountancy body in its latest forecast says Malaysia's economic growth is expected to decelerate to 3.8% in 2013 compared with an estimated growth of at least 5% in 2012.

Conceding that his forecast for Malaysia is one of the most bearish so far, ICAEW's economic advisor and chief executive for the Centre for Economics and Business Research, Douglas McWilliams, explains, "Our less optimistic forecast for the country does not imply that there's anything wrong with Malaysia's economy. It is just that we are generally more pessimistic about the world economy, especially with what's going on in the eurozone economy."

"Coming from Europe, I think we know better than many others the extent and seriousness of the (sovereign debt) problems in the region, which could have a significant impact on the global economy," McWilliams said at a recent interview in conjunction with the release of ICAEW's latest quarterly forecasts, *Economic Insight: Southeast Asia.*

"The weakness of the global economy will definitely have a knock-on effect not only on Malaysia, but on the region as a whole," McWilliams said, adding that he expected Malaysia's economy to be weighed by comparatively weak export performance and lower commodity prices in 2013.

Two-speed world

The truth of the matter is that the structural fragilities plaguing the global economy are still very present. They remain unresolved at this point in time. It is, therefore, only reasonable to expect global economic conditions in 2013 to be more of the same - if not worse.

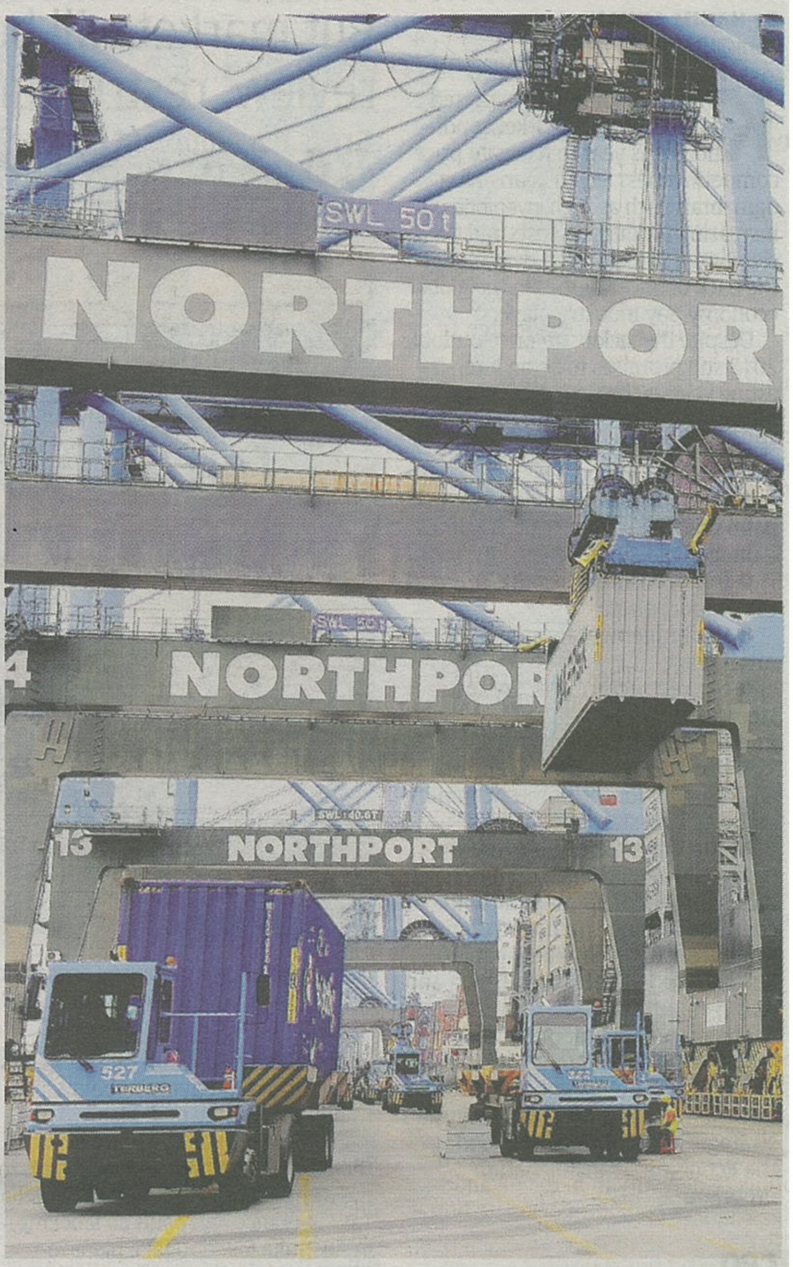
Morgan Stanley, for one, puts it as such: the global economy looks set to remain stuck in the "twilight zone" of lacklustre growth and high dependance on government policies. The leading financial services group bets that the global GDP in 2013 would just grow around 3%, which about the same pace expected for 2012.

The United Nations (UN) paints an even more melancholic picture.

In its recently released *World Economic Situation and Prospects 2013,* the intergovernmental organisation said global GDP growth would likely remain "well below potential" at 2.4%. That projection, though, represented a marginal improvement from the 2.2% global GDP growth that the UN expected for 2012.

No prize for guessing, the root of the sluggish global economy is found in the weaknesses of major developed economies, namely, the United States, European Union (EU) and Japan, or commonly called the Group of Three (G3).

The US economy in 2013 is expected to chug along, growing at roughly the same, uninspiring pace of around 2% as it did in 2012, while debt-mired countries in the EU and deflation-stuck Japan are expected to see low, flat growth at best.



There will be continued weakness in the demand for exports from Asian countries including Malaysia.

What this implies for other Asian economies, including Malaysia, is that there will be continued weakness in the demand for their exports. And if global commodity prices were to remain soft on account of slow demand, the fortunes of resource-rich nations such as Malaysia and Indonesia could also be negatively impacted.

In addition, economists say, uncertainties in the global economy could also spell increased volatility in capital flows to the region. This will have an implication on the performances of their capital markets.

There is a silver lining to the dark clouds, though, as Asia, led by China, remains the bright spot amid the global economic challenges.

China, for one, is expected to grow at a robust 8% in 2013, while India and Indonesia are expected to grow at around 6%.

For most countries in Asia, domestic strength has become their saving grace, providing some cushion to the effects of the global economic weakness andhelping their economies grow. And to a certain extent, the growth of some of these countries has also generated opportunities for regional trade that has further alleviated the pains of the global economic slowdown.

Asia, in general, is set to continue growing relatively robustly this year, maintaining what economists call a "two-speed" world, in which developed nations, especially the G3, are expected to remain sluggish, while emerging economies, especially those in Asia, are expected to keep growing healthily.

Supportive policies

While Malaysia is located among the bright spots of the global economy, and boasts strong domestic demand, the country's prospects, according to most economists, remain hinged on the effective implementation of policies under the GTP and ETP.

"It is imperative for Malaysia to maintain policy clarity and consistency in business and investment regulations to avoid policy missteps," CIMB's Lee argues.

"Of importance is the expedition of reform-oriented policies to build Malaysia's economic resilience," he adds.

Meanwhile, in maintaining the balance between economic growth and inflationary pressures in Malaysia, economists say they expect interest rates in the country to remain stable through 2013. The benchmark overnight policy rate (OPR) currently stands at 3%, which has been supportive of the country's economic growth amid a low inflation environment with consumer price index (CPI) growing at less than 2% in 2012.

But with price pressures expected to pick up next year, with CPI expected to increase around 2% to 3%, some economists expect the OPR to likely be raised by 25 basis points to 3.25% in the second half of next year.